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DOJ Suit Against ValueAct Shines Spotlight on HSR Requirements for Shareholder Activists

Suit signals potential consequences for activist investors who rely on the HSR "solely for purposes of investment" exemption.

On April 4, 2016, the U.S. Department of Justice (DOJ) sued certain ValueAct Capital entities for alleged violations of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act). DOJ alleges that ValueAct failed to report its purchases of a total of over US$2.5 billion in Halliburton and Baker Hughes voting securities. DOJ contends that ValueAct could not avail itself of the "solely for purposes of investment" exemption to HSR because ValueAct intended to influence the parties to pursue their US$35 billion merger and to participate in the parties' strategic decision making.

At stake are substantial fines (~$19 million) and a possible federal court injunction prohibiting future HSR violations that could impact the way ValueAct, and by implication other activist investors, pursue stock accumulations. The suit underscores the importance of thoroughly assessing an investor's intentions before relying upon the HSR solely for purposes of investment exemption (sometimes referred to as the "passive investor exemption").

Implications

Even if DOJ's complaint against ValueAct results in a decision that ValueAct's conduct did not fall within the solely for purposes of investment exemption, the case is not likely to meaningfully impede the ability of activists to accumulate equity interests in a target company. Regardless of the outcome, DOJ's complaint against ValueAct stands as a warning shot across the bow of activist investors that they should avoid actions that are inconsistent with a declared "investment only intent" if they intend to rely upon the solely for purposes of investment exemption. The case could have other implications for stakeholders as well.

Public Companies

- If the ValueAct case results in a more narrow interpretation of the solely for purposes of investment exemption, investors will be required (absent another exemption) to make an HSR filing before accumulating shares in excess of the HSR dollar threshold. Consequently, more public companies will have earlier notice of potential activist accumulations. This will be particularly relevant for larger public companies for which the HSR filing threshold is below the 5% disclosure threshold under Schedule 13D.

- Public companies seeking to mount an activist defense may wish to evaluate potential tactical and strategic implications of the apparently more robust DOJ/Federal Trade Commission (FTC) enforcement paradigm. Earlier advance notice of stock accumulations will afford a public company the opportunity to engage with and respond to an activist investor sooner than would have been the case if the exemption were available.

- There is no private right of action under the HSR Act, so public companies do not have standing to file suit directly in response to suspected violations. However, public companies could use a suspected violation as part of a so called "sand in the gears" tactic to discourage or delay an activist's share accumulation, including by contacting the agencies to report suspected violations.

- Even the threat of agency reporting could pressure an activist investor to delay an accumulation strategy, pending receipt of HSR clearance, or otherwise create leverage for subsequent discussions and negotiations.

Shareholder Activists

- The ValueAct case may drive activists to pursue accumulation strategies that focus on the acquisition of non-voting economic interests (such as through derivative instruments or options) rather than voting shares, as the former are not considered for purposes of the HSR filing requirements.

- In the wake of the DOJ complaint against ValueAct, activists are likely to be more conservative in assessing the necessity of HSR filings. Both DOJ's complaint and its pursuit of injunctive relief reflect not only the increasingly aggressive enforcement posture of DOJ on these matters but also a focus on perceived "repeat offenders."

- Investors will need to be particularly cautious how they state their intentions with respect to a target and how they engage with executives of the target

Background

The HSR Act and the Solely for Purposes of Investment Exemption

Absent an exemption, the HSR Act requires that persons or entities must notify DOJ and the FTC before making certain acquisitions of voting securities valued over US$78.2 million. When a buyer acquires sufficient voting securities through a unilateral action (*e.g.*, open market purchases), rather than a negotiated agreement with the issuer, the buyer also must notify the issuer in writing of the pending acquisition and the fact that the issuer must make an HSR filing. Parties cannot consummate transactions subject to HSR until they have complied with the Act's notification and waiting period requirements. The Act subjects buyers who fail to comply with these requirements to fines of up to US$16,000 per day for the period of non-compliance.

The HSR Act and the Rules promulgated under the HSR Act provide an exemption for acquisitions of voting securities if (a) as a result of the acquisition, the acquiring person holds **10% or less** of the outstanding voting securities of the issuer, ***and*** (b) the acquisition is **solely for the purpose of investment.** (16 CFR 802.9) Under the Rules, voting securities are held or acquired "solely for the purpose of investment" if the person holding or acquiring such voting securities has no intention of participating in the formulation, determination, or direction of the issuer's basic business decisions. To date, no court has considered the scope and application of this rule.

The Statement of Basis and Purpose for the HSR Rules provides a non-exhaustive list of types of conduct that may disqualify an investor from the exemption, including:

- Nominating a candidate for the board of directors of the issuer
- Proposing corporate action requiring shareholder approval
- Soliciting proxies
- Allowing a controlling shareholder, director, officer or employee simultaneously serve as an officer or director of the issuer
- Competing against the issuer

Recent Enforcement and Guidance

Just last year, Third Point LLC agreed to settle FTC charges that Third Point improperly failed to report its acquisitions of stock in Yahoo! Inc. The FTC alleged that Third Point's actions were inconsistent with an investment-only intent, and thus its acquisitions were not covered by the solely for purposes of investment exemption. These actions included asking individuals if they would be interested in an executive or board position at Yahoo, communicating to Yahoo that Third Point was prepared to join Yahoo's board, and internally discussing whether to launch a proxy battle for Yahoo directors. Third Point agreed to a settlement with the FTC under which it was prohibited from relying on the investment-only exemption if it had: contacted third parties to gauge their interest in joining the board of the target company; communicated with the target company about proposed candidates for its board; or engaged in other specified conduct in the four months prior to acquiring voting securities above the HSR Act threshold. However, Third Point avoided any fines because it was the company's first HSR violation, and the FTC determined that the violation was inadvertent and short-lived.

Similarly, the Premerger Notification and Practice Manual (which the American Bar Association recently published and the FTC reviewed) advises that the following actions (among others) are inconsistent with investment-only intent: demanding the target's shareholder list to discuss a proposed transaction, retaining the services of a proxy solicitation firm, and planning to merge with, liquidate, or reorganize the target.

The Complaint Against ValueAct

Following the announcement of the proposed merger of Baker Hughes and Halliburton on November 17, 2014, ValueAct began acquiring shares in the two companies, exceeding the HSR filing threshold for each within a few weeks. Relying on the solely for purposes of investment exemption, ValueAct did not submit HSR filings for the acquisitions. According to DOJ's complaint, ValueAct's purchases did not qualify for the solely for purposes of investment exemption because: (a) at the time of the purchases, ValueAct planned to influence the business decisions and management of both companies, and (b) ValueAct actively engaged with the executives of both companies to implement those plans.

DOJ has alleged over a dozen examples of ValueAct conduct that, according to the agency, disqualified ValueAct from relying upon the exemption. Among the disqualifying conduct were documents that allegedly indicate ValueAct's intent to play an active role in the strategy of both companies. In one instance, ValueAct allegedly circulated a memo to investors stating that its significant holdings in Baker Hughes and Halliburton would enable ValueAct either to help close the deal, or to help the companies modify the agreement to secure merger approval from DOJ. ValueAct also allegedly met with senior executives of both companies to influence management, formulate business strategies and discuss alternatives to closing the transaction. According to DOJ's complaint, ValueAct proposed that Halliburton buy pieces of Baker Hughes and offered to apply pressure to Baker Hughes to accept the deal. "In short,

ValueAct offered to use its position as a shareholder to pressure Baker Hughes's management to change its business strategy in ways that could affect Baker Hughes's competitive future," DOJ alleged.

DOJ's decision to pursue this case is consistent with its general practice to penalize companies that repeatedly and/or intentionally neglect to submit required HSR filings. Correspondingly, the antitrust agencies rarely pursue penalties for a company's first inadvertent failure to comply with the HSR requirements (as opposed to willful violations). Here, ValueAct had two prior HSR violations. The firm first missed filings in 2003, and was required to submit corrective filings and outline an HSR compliance plan. Then, two years later, the firm again failed to make required filings and paid a civil penalty of US$1.1 million.

For this alleged third violation, DOJ has sought as relief both the available civil penalties as well as an injunction from a federal court against further HSR Act violations. If the court grants the injunction, ValueAct will not be able to rely on the solely for purposes of investment exemption for a specified period of time if it takes any action that falls on the list of prohibited actions identified above, or otherwise acts in a manner inconsistent with an "investment only" intent. If ValueAct violates the injunction, the firm could be found in contempt, risking much greater civil penalties.

ValueAct has stated it intends to contest DOJ's lawsuit. The firm's willingness to litigate the case suggests ValueAct believes that the agencies' interpretation of the solely for purposes of investment exemption is too narrow. If there is a judgment or other ruling in the case, it could provide the first judicial interpretation of the scope of the exemption and could clarify the conditions by which the agencies can require HSR filings from activist investors who pursue stock accumulations.

A link to DOJ's press release can be found here.

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